

Letter of Findings: 04-20110572
Gross Retail Tax
For the Years 2009 and 2010

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ISSUES

I. Manufacturing Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); General Motors Corp. v. Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Mumma Bros. Drilling Co. v. Dept. of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(f\)\(3\)](#); [45 IAC 2.2-5-8\(g\)](#); [45 IAC 2.2-5-8\(k\)](#); [45 IAC 2.2-5-8\(h\)\(2\)](#).

Taxpayer argues that its purchase of parts used with its "Bolt-a-Blok" machine and parts used for its forklift are exempt from sales/use tax.

II. Construction Materials – Gross Retail Tax.

Authority: IC § 6-2.5-3-7(b); IC § 6-2.5-5-6; IC § 6-8.1-5-1(c); [45 IAC 2.2-5-14\(a\)](#); Sales Tax Information Bulletin 60 (July 2006).

Taxpayer maintains that the construction materials it purchased were not subject to sales/use tax because the materials were resold to its sister company.

STATEMENT OF FACTS

Taxpayer is an Indiana business which fabricates structural steel parts. The parts include joists, floor decks, stairways, and handrails. The Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The Department's audit concluded that Taxpayer owed additional sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

Simultaneous with the Taxpayer's audit, the Department also conducted an audit of Taxpayer's sister corporation. The sister corporation is in the business of designing and constructing commercial and industrial buildings. Taxpayer and sister corporation work hand-in-hand. Taxpayer fabricates structural steels parts, sister corporation purchases the steel parts, and sister corporation incorporates those parts into a completed buildings.

I. Manufacturing Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer argues that its purchases of parts for its "Bolt-a-Blok" machine and for its forklift are exempt from sales/use tax.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption such as that sought by Taxpayer, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). A statute which provides a tax exemption, however is strictly construed against the taxpayer. Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 100-101.

In Indiana, a sales tax is imposed on retail transactions, and a complementary use tax is imposed on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. In this instance, Taxpayer necessarily relies on the tax exemption found at IC § 6-2.5-5-3(b). That particular exemption states that: "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." (Emphasis added). It is Taxpayer's contention that the parts used on the "Bolt-a-Blok" machine and parts used on the forklift fall within the definition of "direct use" as provided in [45 IAC 2.2-5-8\(c\)](#). That regulation reads as follows:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being

produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

[45 IAC 2.2-5-8](#)(d) helps to define the point at which "production" begins and the point at which "production" stops.

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The Department's regulation, [45 IAC 2.2-5-8](#)(k) further defines the boundaries of the "production process" as follows:

"Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property" is performance as a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different production having a distinctive name, character, and use. Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition.

Indiana applies a "double direct" test in determining whether equipment is exempt. The state's manufacturing exemption, "fairly read, is meant to exempt capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Dept. of Revenue*, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The court has held that capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining or finishing of tangible personal property." *Indiana Dept. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983) (Emphasis added). "[T]he test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. *General Motors Corp. v. Dept. of State Revenue*, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991).

A. "Bolt-a-Blok" Parts.

Taxpayer purchased drills bits and repair parts for its "Bolt-a-Blok" machine. Publicly available information describes the "Bolt-a-Blok" construction technique as follows:

Bolt-A-Blok is a revolutionary, unitized post-tensioned, mechanically fastened block system. Quality concrete blocks are connected mechanically by anti-corrosive steel fasteners and bars. The fasteners and bars provide post tensioning which increases the overall capacity and acts as steel reinforcement to the wall.
<http://www.boltablok.com/about.htm>

Taxpayer's device fabricates the "anti-corrosive steel fasteners and bars." The photographs supplied by Taxpayer present what appears to be a framework or "jig" upon which the fasteners and bars are constructed. A blank metal bar is placed on the device. A "programmable logic controller" operates a series of electric tools which drill and countersink multiple holes in the metal bar at each of a series of seven stations.

Taxpayer purchases drill bits and parts for this device and it is these drill bits and parts which Taxpayer believes are exempt. In this case, Taxpayer has presented sufficient evidence to establish that the "Bolt-a-Blok" machine is directly used in the direct production of Taxpayer's structural steel building components. Therefore, the drill bits and repair parts are exempt. See [45 IAC 2.2-5-8](#)(h)(2) ("Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment are exempt from tax.")

B. Forklift.

Taxpayer purchased fork-lift repair parts. Taxpayer maintains that the fork-lift is used within the production of its structural steel components. Taxpayer estimates that the fork-lift is used in an exempt manner 50 percent of the time.

The regulation on which Taxpayer depends is found at [45 IAC 2.2-5-8](#)(f)(3) which states that:

Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

The same regulation, [45 IAC 2.2-5-8](#)(g) provides examples of situations in which a fork-lift is used both in an exempt manner and in a non-exempt manner.

(3) A forklift is used exclusively to move work-in-process from a temporary storage area in a plant and to transport it to a production machine for processing. Because the forklift functions as an integral part of the integrated system comprising the production operations, it is exempt.

(4) A forklift is used exclusively to move finished goods from a storage warehouse and to load them on trucks for shipment to customers. The forklift is taxable because it is used outside the integrated production process.

(5) A forklift is regularly used 40[percent] of the time for the purpose described in Example (3) and 60[percent] of the time for the purpose described in Example (4). The taxpayer is entitled to an exemption equal to 40[percent] of the gross retail income attributable to the transaction in which the forklift was purchased.

Taxpayer asks that fork-lift parts be granted a fifty-percent exemption on the ground that the fork-lift is used in

an exempt fashion 50 percent of the time and used in a non-exempt fashion 50 percent of the time. The Department is unable to agree with Taxpayer's contention because – although an apportionment is permitted under the regulation – Taxpayer's contention is not supported by the facts presented. Other than Taxpayer's bare assertion that the fork-lift is used in an exempt manner 50 percent of the time, there is nothing substantive on which to base the requested partial exemption. It is long established that where a taxpayer claims an exemption from the tax, "the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." RCA Corp., 310 N.E.2d at 100-101. Taxpayer's claim does not present sufficient evidence to bring it within the exact letter of the law.

FINDING

Taxpayer's protest is denied in part and sustained in part. The parts and supplies for Taxpayer's "Bolt-a-Blok" are exempt; the parts and supplies for its fork-lift are not exempt.

II. Construction Materials – Gross Retail Tax.

DISCUSSION

Taxpayer purchased construction materials including joints, "bridging," decking, and fasteners. Taxpayer did not pay sales tax when it purchased the construction materials. Taxpayer did not self-assess use tax when it incorporated the parts into its structural steel parts. Taxpayer did not collect tax from its sister corporation when it sold the structural steel parts because sister corporation presented Taxpayer with an exemption certificate for each transaction.

Taxpayer was advised that it incurred neither sales nor use tax on the construction materials and that it could sell the structural steel components without collecting sales tax. Sister corporation was advised that it was not required to pay sales tax when it purchased the structural steel components because it was entering into "inter-company" transactions. Sister corporation was advised that it was not required self-assess sales tax on the structural steel components because it was incorporating the structural steel components into its customers' real property. Sister corporation was advised that it was not required to collect sales tax from its customers because it was charging those customers pursuant to a lump-sum contract. In effect, Taxpayer was advised that – unlike its competitors – Taxpayer and sister corporation entered into a mutually beneficial relationship which allowed both Taxpayer and sister corporation to entirely avoid all sales and use tax on construction materials and structural steel components. Taxpayer received bad advice.

The audit assessed sales tax on "raw materials" which were used to construct the structural steel components Taxpayer sold to sister corporation. The issue is whether Taxpayer was required to self-assess use tax on those raw materials. As noted previously, IC § 6-8.1-5-1(c), requires that Taxpayer demonstrate that the original assessments were wrong.

Indiana law allows an exemption on the purchase of property incorporated into manufactured goods. IC § 6-2.5-5-6 provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

The Department's regulation, [45 IAC 2.2-5-14\(a\)](#), states:

The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as an integral part of the tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing.

As noted previously in Part I above, Taxpayer purchased raw materials which it used to construct structural steel building components. Because Taxpayer is ostensibly in the business of manufacturing these building components, the raw materials purchased and incorporated into the building components are exempt.

The second issue is whether Taxpayer was required to collect sales tax when it sold the structural steel components to sister corporation. The rule is simple; if a "retail merchant" sells tangible personal property to a customer which presents an exemption certificate, the "retail merchant" is not required to collect sales tax. IC § 6-2.5-3-7(b) states:

A retail merchant is not required to produce evidence of nontaxability... if the retail merchant receives from the person who acquired the property an exemption certificate which certifies, in the form prescribed by the department, that the acquisition is exempt from sales tax.

Taxpayer represents that it sold the building components to its sister corporation in retail transactions, that it was acting as a retail merchant when it did so, and that sister corporation provided a valid exemption certificate each time a transaction occurred. As such, the Department is prepared to accept Taxpayer's assertion that it was not required to collect sales tax when it sold building components to sister corporation.

The Department's audit division is requested to review the original audit report and to make whatever adjustments are warranted by this Letter of Findings and by Taxpayer's documentation.

However, it should be noted with absolute clarity that the conclusions reached in this Letter of Findings are necessarily contingent upon Taxpayer's consistent and accurate representation as to its business relationship with sister corporation. For example, sister corporation now claims that it was entitled to purchase the

components exempt because it was later required to self-assess use tax on the steel building components purchased from Taxpayer because it incorporated those components into structures which it sold its customers under a lump sum contract. See Sales Tax Information Bulletin 60 (July 2006), 20060823 Ind. Reg. 045060287NRA.

FINDING

Subject to finalization of the audit review of Taxpayer's sister corporation and review of the documents presented at the time of the administrative hearing, Taxpayer's protest is sustained.

SUMMARY

The parts and supplies for Taxpayer's "Bolt-a-Blok" are exempt; the materials purchased to construct Taxpayer's structural steel components are exempt; Taxpayer's fork-lift parts are not exempt; Taxpayer was not required to collect sales tax when it sold structural steel components to customers which presented valid exemption certificates.

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